IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 240

ANDRE MAXIMOV, as Trustee for the Benefit of H. ROBBIN FEDDEN, u/a dated 10/24/47,

Petitioner,

against

THE UNITED STATES OF AMERICA,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

D. NELSON ADAMS,
Counsel for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

JOHN A. REED

Of Counsel:

DAVIS POLK WARDWELL SUNDERLAND & KIENDL,

HILL BETTS YAMAOKA FREEHILL & LONGCOPE.

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PETITION FOR WRIT OF CERTIORARI TO UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

To the Honorable the Chief Justice and the Associate Justices of the Supreme Court of the United States:

Petitioner respectfully asks that a writ of certiorari be issued to review the judgment of the United States Court of Appeals for the Second Circuit reversing the judgment of the United States District Court with directions to enter judgment for the defendant.

Opinion Below.

The opinion of the Court of Appeals is reported in 299 F. 2d 565 and is printed in the Appendix (A-1)*.

* The designation "(A)" refers to the Appendix hereto and the designation "(R)" refers to the "Appendix B to Brief for Appellant" in the Court of Appeals.

Statement of Jurisdiction.

The judgment of the Court of Appeals was entered on February 14, 1962, and the jurisdiction of this Court is invoked under 28 U. S. C. § 1254(1).

Question Presented.

The question is whether capital gains realized by a trustee of a United States trust, when held for future distribution to citizens and residents of the United Kingdom, are exempt from Federal income tax under the Income Tax Convention between the United States and the the United Kingdom as implemented by Section 894 of our Internal Revenue Code of 1954 and by Section 22(b)(7) of our Internal Revenue Code of 1939.

Treaties, Statutes and Regulations Involved.

Section 894 of our Internal Revenue Code of 1954 provides broadly:

> "Sec. 894. Income Exempt Under Treaty.
>
> Income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle."

Section 22(b)(7) of the Internal Revenue Code of 1939 was to substantially the same effect.

Since 1936 when Section 22(b)(7) was first enacted, it has been the declared policy of Congress to give full recognition to treaty provisions in case of any conflict between the treaty and our domestic revenue laws. Section 22(b)(7) was limited to exemptions in treaties, but in 1942 Congress broadened the policy so that it embraced any treaty obligation. Thus in the Revenue Act of 1942 making certain

amendments to the 1939 Code, Section 109 entitled "Treaty Obligations" provided:

> "No amendment made by this title shall apply in any case where its application would be contrary to any treaty obligation of the United States."

And again in enacting the Internal Revenue Code of 1954, Congress expressly provided in Section 7852(d):

> "(d) Treaty Obligations. — No provision of this title shall apply in any case where its application would be contrary to any treaty obligation of the United States in effect on the date of enactment of this title."

The exemption here claimed arises under the Income Tax Convention with the United Kingdom. In particular, Article XIV provides:

> "A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets."

Other pertinent portions of the Convention, which portions have remained unchanged since the Convention became effective, are reproduced in the Appendix hereto (A-13-19). We there print also the other material parts of the Internal Revenue Codes of 1954 and 1939 (A-20-25).

Treasury Decision 5569 comprises the Commissioner's regulations applicable to the Convention. 1947-2 Cum. Bull. 100, 109. Section 7.519, subparagraph (c), of T. D. 5569 provides:

> "(c) *Beneficiaries of an Estate or Trust.* — A nonresident alien who is a resident of the United Kingdom and who is a beneficiary of a domestic estate or trust, shall be entitled to the exemption, or reduction in the rate of tax, as the case may be, pro-

vided in Articles VI, VII, VIII, IX and XIV of the convention with respect to dividends, interest, royalties, natural resource royalties, rentals from real property and capital gains to the extent such item or items are included in his distributive share of income of such estate or trust if he is taxable in the United Kingdom on such income and is not engaged in trade or business in the United States through a permanent establishment."

Statement of the Case.

The petitioner is the duly qualified successor trustee of a certain *inter vivos* trust created by H. Robbin Fedden (hereinafter sometimes referred to as the grantor) (R 3b, 4b, 13b-21b). During 1954 and 1955 the trustee sold part of the property constituting the corpus of the trust at a profit (R 3b, 4b). The trustee duly filed Federal income tax returns, reporting the sale and the amount of profit and paid the District Director of Internal Revenue capital gain taxes of $53.10 for 1954 and $1,316.32 for 1955 (R 3b). Thereafter, a claim for refund was filed with the District Director of Internal Revenue, asserting that such taxes were erroneously and illegally collected (R 3b). The claim for refund was denied in full (R 3b) and this suit followed (R 3b, 4b), the jurisdiction of the District Court having been invoked because this is a suit for refund of Federal income taxes.

Throughout 1954 and 1955 all the income beneficiaries of the trust and all the remaindermen of the trust were residents of the United Kingdom of Great Britain and Northern Ireland and were not engaged in trade or business in the United States (R 22b, 23b).

The Court below held that capital gains realized by the trustee of a United States trust when currently distributable are exempt under the United Kingdom Convention, but that the capital gains when held for future distribution are not exempt.

Reasons for Allowance of the Writ.

The Decision of the Court of Appeals Conflicts with a Decision of the Court of Appeals for the Ninth Circuit.

In *American Trust Company* v. *Smyth*, 247 F. 2d 149 (9th Cir. 1957), the facts were directly in point with the present case. The Court of Appeals for the Ninth Circuit held that capital gains realized in 1946 by a trustee of a United States trust when held for future distribution to citizens and residents of the United Kingdom are exempt from Federal income tax under the United Kingdom Convention.

It is evident from its opinion that the Court below recognized that its decision was in conflict with this decision of the Court of Appeals for the Ninth Circuit. It stated (A-10, 11):

> "In so holding, we are not unmindful of the decision of the Ninth Circuit in *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, which held under similar circumstances that Article XIV created an exemption. * * * For the reasons advanced above we believe that decision to be erroneous, * * *."

The Importance of the Question Presented.

The question presented is involved in many cases now pending before the Internal Revenue Service and the courts and as the opinion below further pointed out, objective thinking on the subject is also at variance. Said the Court below in conclusion (A-11):

> "See in accord with the view we are taking, the Note, 71 Harv. L. Rev. 1163 (1958), though contra are Note, 9 Stan. L. Rev. 610 (1957), and Note 33 N. Y. U. L. Rev. 233 (1958)."

In view of the present uncertain state of the law, trustees of American trusts, the beneficiaries of which are British, have a fiduciary duty to contest any liability for the

capital gains tax unless and until an ultimate judicial determination of the question is obtained.

An international treaty between two sovereign nations is a document which may not be lightly set aside. Yet this in effect is what the Court below has done.

In the case here involved, the Congress has expressly implemented any exemption accorded in our income tax conventions with other nations, for Section 894 of our Internal Revenue Code of 1954 and the corresponding Section 22(b)(7) of our Revenue Code of 1939 provide broadly that "Income of any kind" shall be exempt from taxation "to the extent required by any treaty".

Throughout the Convention the primary objective was the accomplishment of full reciprocity and equality of tax treatment between the nationals of the contracting parties. In a reverse but like situation, the United Kingdom did not impose a tax on capital gains from the sale of property in trust. Article XIV was intended to put the nationals of both parties on the same footing. Unless Article XIV is given the broad interpretation for which we contend, it will be the one article which does not accomplish reciprocity.

Conclusion.

In summary, this case presents a decision by the Court of Appeals that is in conflict with a decision of another Court of Appeals as to the interpretation of a tax treaty and there are many cases now pending in the Internal Revenue Service and in the courts awaiting resolution of this conflict. Under the circumstances the obvious importance of the question presented herein calls for an exercise of this Court's power of review.

Respectfully submitted,

D. NELSON ADAMS,
Counsel for Petitioner,
1 Chase Manhattan Plaza,
New York 5, New York.

JOHN A. REED

Of Counsel:

DAVIS POLK WARDWELL
SUNDERLAND & KIENDL,

HILL BETTS YAMAOKA
FREEHILL & LONGCOPE.

APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 118—September Term, 1961.

(Argued November 30, 1961 Decided February 14, 1962.)

Docket No. 26984

ANDRE MAXIMOV, as Trustee for the benefit of H. Robbin Fedden u/a dated 10/24/47,

Plaintiff-Appellee,

—v.—

UNITED STATES OF AMERICA,

Defendant-Appellant.

Before:

CLARK, FRIENDLY and KAUFMAN,

Circuit Judges.

Appeal from the United States District Court for the Southern District of New York, Lloyd F. MacMahon, *Judge*.

The United States of America appeals from the grant of a refund of income taxes for 1954 and 1955 on an American *inter vivos* trust as being exempt therefrom under Article XIV of the Income Tax Convention between the United

States and the United Kingdom. Reversed for judgment for defendant.

RICHARD J. MEDALIE, Atty., Dept. of Justice, Washington, D. C. (Louis F. Oberdorfer, Asst. Atty. Gen., Meyer Rothwacks, Atty., Dept. of Justice, Washington, D. C., and Robert M. Morgenthau, U. S. Atty., S. D. N. Y., New York City, on the brief), *for defendant-appellant.*

WILLIAM F. SUGLIA, of Hill, Betts, Yamaoka, Freehill & Longcope, New York City (John F. Lang, of Hill, Betts, Yamaoka, Freehill & Longcope, New York City, on the brief), *for plaintiff-appellee.*

CLARK, *Circuit Judge*:

The taxpayer, Andre Maximov, is the successor trustee of an *inter vivos* trust created in 1947, under the laws of Connecticut, by H. Robbin Fedden. Under the terms of the trust instrument all income is to be paid to the grantor during his life; on his death the income is payable to his wife if she survives him and is still married to him. On her death if she qualifies for this life estate, or on the grantor's if she does not, the entire principal of the trust is to be paid to the surviving issue of the grantor in equal shares, *per stirpes,* with limitations not here relevant. At the time the trust was created, and at all times thereafter, the grantor-beneficiary and his wife and children have resided in England.

During its taxable years 1954 and 1955 the trust realized net long-term capital gains from the sale of securities, resulting in tax liabilities of $53.10 and $1,316.32 respec-

tively. Under Connecticut law these gains were retained as corpus.[1] Maximov, as trustee, filed federal fiduciary income tax returns for 1954 and 1955 with the District Director of Internal Revenue for Lower Manhattan reporting these gains, and paid the appropriate tax. Several years later, however, he filed a claim for refund of the tax on these two capital transactions, contending that as the gains were realized by a trust whose beneficiaries reside in the United Kingdom, they are exempt from United States tax under Article XIV of the Income Tax Convention between the United States and the United Kingdom, 60 Stat. (Part 2) 1377.

Under United States tax law the trust is treated as a separate taxable entity. *Freuler* v. *Helvering*, 291 U. S. 35. Income received by the trust and not distributable to the beneficiaries, or not includable in the trust's distributable net income, is taxable to the trust. As the income involved here was neither distributable nor part of the distributable net income of the trust, Internal Revenue Code of 1954, § 643(c), these gains are considered the income of the trust, taxable to it, and are not the income of the life tenant or the remaindermen.

The Convention grants an exemption from United States tax on gains from the sale or exchange of capital assets to residents of the United Kingdom not engaged in a trade or business within the United States. Article XIV, 60 Stat. (Part 2) 1384. Were the trust a "resident" of the United Kingdom, as such a resident is defined in the Convention, or were this income includable in the gross income of the grantor-beneficiary, who is a resident of the United Kingdom and not engaged in a trade or business here, the exemption would be clearly applicable. See T. D. 5569, 1947-2 Cum. Bull. 100, § 7.519(c). The difficulty which this case presents is that the trust is not a United Kingdom resident

[1] Conn. Gen. Stat. Ann. § 45-112 (1958)

and the income here is treated in United States law as that of the trust.[2] Since the exemption of Article XIV explicitly applies only to *residents* of the United Kingdom, the taxpayer's claim can be sustained only if we disregard the separate tax treatment accorded trusts by United States law.

This is precisely what the taxpayer urges us to do. He asserts that the word "exempt" in Article XIV should be read as signifying a "release from economic burden," and that as the economic burden of the tax falls here on United Kingdom residents—the grantor-beneficiary and his family—the exemption must be read as applying in this case. In support of this contention the taxpayer maintains that one purpose of the tax convention was to achieve reciprocity of tax treatment for the nationals of the contracting parties. Thus, he argues, the aim of Article XIV was to secure for United Kingdom residents realizing capital gains in the United States precisely the same treatment that a United States resident would be given on similar gains realized within the tax jurisdiction of the United Kingdom. Since the United Kingdom does not impose any income tax on profits it considers capital gains, and would not impose any tax on either an English trust or its bene-

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[2] A resident of the United Kingdom is defined as "any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax." Art. II(1)(g), 60 Stat. (Part 2) 1378. That this definition applies to the trust is clear. Art. II(3), 60 Stat. (Part 2) 1379, states that terms not defined in the Convention shall have the meaning given them by the laws of the country which is applying the treaty to a question of domestic taxation. Since the word "person" is not defined in the treaty, it is necessary to resort to United States law to determine whether or not a trust is a "person." Under United States law, as under British law, the term "person" encompasses a trust. Internal Revenue Code of 1954, § 7701(a)(1), 26 U. S. C. § 7701(a)(1); Harvard Law School, World Tax Series, Taxation in the United Kingdom, ¶¶ 5/3.1, 5/3.4, pp. 125, 127 (1957). Since this trust is resident within the United States for purposes of United States tax, it cannot be considered a resident of the United Kingdom.

ficiaries, whether they were residents of the United States or the United Kingdom, it would, so the argument runs, defeat the manifest purposes of the Convention to deny the exemption here.[3] We must, it is therefore urged, ignore the United States rule that the trust is a separate entity, treat trust and beneficiary as one taxpayer, and allow as a deduction from the trust income the exemption granted the beneficiary by the Convention. In essence the contentions are threefold: that Article XIV was designed to achieve equality of tax treatment; that even though the parties did not explicitly provide for an exemption in this situation, the Convention must be read as if they did in order to further the objective of equality; and that this construction must be adopted, regardless of its impact on domestic tax policy.

As we are unable to find any explicit consideration of the issues thus raised in the language or background of the agreement, these contentions require a fundamental evaluation of the purposes and aims of the Convention. The basic aim of treaty interpretation is to ascertain the intent of the parties who have entered into agreement, in order to construe the document in a manner consistent with that intent. *Rocca* v. *Thompson*, 223 U. S. 317, 331-332; Restatement, The Foreign Relations Law of the United States §129 (Tent. Draft No. 3, 1959). And to give the specific words of a treaty a meaning consistent with the genuine shared expectations of the contracting parties, it is necessary to examine not only the language, but the entire context of agreement. We must therefore examine all available evidence of the shared expectations of the parties to the Convention in order to answer the interrelated questions whether Article XIV was designed to achieve equality of tax treatment, and whether alterations of domestic tax law as are here proposed to realize such

[3] For a discussion of United Kingdom taxation of capital gains, see note 4 *infra*.

equality are themselves consistent with the intent of the contracting parties.

An examination of the full text of the Convention and the context of agreement indicates that, while one of the reasons Article XIV was included in the Convention was to achieve "equality" of tax treatment, imposition of a tax in the circumstances of this case would not be inconsistent with this objective. For the "equality" the parties strived for in this Article, as in similar provisions, was a limited one; they struck a rough bargain and were willing to tolerate marginal inequities of the sort involved in this case. While this dilutes the force of the taxpayer's argument, it alone might not require a denial of the exemption. But further principles must be considered. There is strong evidence that in the several Articles whose primary aim was to achieve substantial equality of tax treatment as between nationals of the contracting parties, the mutual concessions made were clearly delimited within the four corners of the instrument. Where it was necessary to make adjustments in domestic provisions in order to achieve the objectives of the Article, these were made explicitly. Thus to sanction free-wheeling adjustment of domestic provisions to achieve point-by-point equality would be to risk undoing the bargain reached by the two nations. Finally, the Convention did not aim at achieving "equality" in a vacuum; the adjustments made equalizing tax treatment were made to achieve broader objectives of the treaty. Denial of the exemption here, while admittedly resulting in some inequality of tax treatment, will not affect those primary purposes.

Although Article XIV on its face is a one-way concession by the United States, it was designed to and does render the tax treatment of United Kingdom residents realizing capital gains in the United States substantially equal to that of the United Kingdom. As we have said, it is reciprocal because the United Kingdom does not tax those prof-

its it classifies as capital gains. But it does not achieve complete equality. In some ways the provision is more beneficial to the United States, for it exempts the gains of only those United Kingdom residents who are not engaged in a trade or business in the United States, while as a result of the United Kingdom policy of not taxing capital gains, a United States resident will be free of United Kingdom tax, regardless of whether he engages in a trade or business. On the other hand, the Convention sanctions the imposition of United Kingdom taxes in some instances where, as a result of Article XIV, a United Kingdom resident would be free of United States tax. For in many instances the United Kingdom does impose its standard tax on transactions which are considered to be the sale or exchange of capital assets under United States law, and in some cases this would result in "unequal" treatment.[4] For these reasons it cannot be said that, by including Article XIV in the Convention, the parties expected to establish wholly congruent tax treatment of capital gains realized by each other's residents.[5]

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[4] It is commonly believed that Great Britain imposes no taxes on capital gains. This is true on a verbal level, and on a verbal level only. Comparative analysis of the two tax systems indicates that many functional transactions given capital-gains treatment in the United States are taxed as ordinary income in Great Britain. For example, gain on the sale of securities by an investment company is considered a capital gain in the United States and is taxed at the lower capital-gains rates. Internal Revenue Code of 1954, §§ 822, 832, 852. In the United Kingdom the same profits, far from being tax free, are treated as income and thus subject to the full standard tax. *Northern Assurance Co.* v. *Russell*, [1889] 2 T. C. 551 (U. K.). Other examples abound. Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 134, *passim*.

[5] Indeed, the Senate Committee which studied the Convention prior to ratification considered the possibility that, as a result of the disparity of capital-gain taxation between the countries, the United Kingdom resident would be at an advantage in some circumstances. Hearings on Executive D and E before a Subcommittee of the Committee on Foreign Relations of the United States Senate, 79th Cong., 1st Sess. 75 (1945). [Hereinafter cited as Hearings.]

Scrutiny of the manner in which this and similar Articles were drafted reinforces the conclusion that whatever "equality" the contracting parties desired to achieve was clearly defined in the Convention. These Articles were drafted with technical precision; no room was left for further adjustments of domestic law. Article VI, 60 Stat. (Part 2) 1381, provides a clear example. In order to equalize the treatment of dividends—a difficult task because of the great difference in United States and United Kingdom concepts of the nature of corporate profits—complex adjustments were made in the rates and manner of taxing of both countries. The United States lowered its rates, while the United Kingdom granted an exemption from surtax. This Article did not achieve a complete equivalence of treatment; the result of the adjustments was to guarantee that the total tax burden imposed by each nation would be approximately the same. On close analysis Article XIV emerges as a similar technical adjustment. It is not a general exhortation to equality; it is addressed only to an exemption from United States tax, and is couched in the technical terminology of the Internal Revenue Code.[6] Despite possible inequities which might arise from *United Kingdom* taxation of United States residents' gains, no provision was made for relief from United Kingdom tax.[7]

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[6] The Convention was the result of a series of mutual concessions; there is evidence that Article XIV reflects a concession given by the United States in return for the counterconcession that the United Kingdom would co-operate in the exchange of tax information. Hearings, p. 62. Since the British policy of secrecy had stymied a prior attempt to negotiate a tax convention in 1937, *id.* at 56, it is clear that the bargain made was an important one.

[7] It is true, as the taxpayer points out, that some of the differences between the two systems will be further equalized by the application of Article III(2), 60 Stat. (Part 2) 1380, which exempts United States enterprises not engaged in trade or business in the United Kingdom from United Kingdom tax on industrial or commercial profits. Instead of weakening our conclusion, however, this section reinforces it. Since Article III(2) applies only to "enterprises," it does not create the across-the-board equality

The broad aim of the Convention, as with income tax treaties generally, was to facilitate commercial enterprise between the two countries.[8] Specifically, the Convention was designed to avoid double taxation and prevent fiscal evasion.[9] The prime target was double taxation, which, because of the high rates of income taxation then and now prevailing in the two nations, constituted what the Secretary of State called "an undesirable impediment to international trade."[10] A primary motivation for inclusion of provisions equalizing tax treatment such as Article XIV was reduction of tax barriers to the free movement of individuals for commercial purposes.[11] And exemption here is unnecessary to achieve these ends. There can be no double taxation, since neither the beneficiary[12] nor the ultimate recipients of the corpus[13] will be taxable in the United Kingdom on these gains. Thus we cannot see that such an exemption would affect commercial intercourse between the two countries in any significant manner.

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urged here. See Article II(1)(j), 60 Stat. (Part 2) 1379. *Cf.* Ehrenzweig & Koch, Income Tax Treaties § 211, p. 206 (1949). And the fact that Article III(2) will operate to eliminate some of the possible inequities created by Article XIV buttresses our conclusion that the latter Article was carefully drafted, and overrides domestic law only as explicitly specified.

[8] Memorandum prepared for the Committee on Foreign Relations, United States Senate, Relative to Convention with Great Britain and Northern Ireland with Respect to Taxes on Income. Printed at Hearings, pp. 23, 27.

[9] 60 Stat. (Part 2) 1377.

[10] Hearings, p. 2. See also *id.* at 42.

[11] *Id.* at 27.

[12] See *Jones* v. *Leeming*, [1930] A. C. 415; Brudno & Hollman, *The Taxation of Capital Gains in the United States and the United Kingdom*, 1958 Brit. Tax Rev. 26, 42.

[13] *See Trustees of the Will of Brodie* v. *Commissioners of Inland Revenue*, 17 T. C. 432, 438 (K. B. 1933) (dictum). *Cf.* Harvard Law School, World Tax Series, Taxation in the United Kingdom ¶10/7.2, pp. 307-308 (1957).

With this background we must examine the taxpayer's argument that "exempt" as used in Article XIV must be read as signifying a "release from economic burden." Of course the first difficulty with this argument is that it is wholly unclear that the entire economic burden of the tax will fall on United Kingdom residents. Since the tax constitutes a charge on the corpus, it will affect the present beneficiary only slightly by reducing the income; and it is difficult to say now that when the ultimate recipients of the corpus take, they will all be residents of the United Kingdom. As we have indicated, adoption of such a broad interpretation of Article XIV is unnecessary to further the objectives of the Convention, and is inconsistent with the manner in which this provision was drafted. In these circumstances we can see no reason to override the technical language of the Convention which, in conjunction with the Internal Revenue Code, as incorporated by Article II(3), recognizes the trust as a separate taxable entity.

This is the interpretation of the Treasury Department taken in its original regulations issued in conjunction with the Convention. These regulations took the position that a nonresident alien beneficiary of a domestic trust was exempt from tax on capital gains accrued by the trust only in so far as the gains are includable in his distributive share of the trust's income. T. D. 5569, 1947-2 Cum. Bull. 100, § 7.519(c). A similar position recognizing that the trust is a separate taxable entity for the purpose of determining treaty exemptions has been taken in the interpretation of all our tax conventions.[14] We hold that this is the correct interpretation of Article XIV of this Convention.

In so holding, we are not unmindful of the decision of

[14] E.g., Australia, T. D. 6108, Cum. Bull. 1954-2, 614, § 501.10; Austria, T. D. 6322, Cum. Bull. 1954-1, 132, § 516.8; Belgium, T. D. 6160, Cum. Bull. 1956-1, 815, § 504.119; France, T. D. 6273, Cum. Bull. 1956-1, 837, § 514.7; Switzerland, T. D. 6149, I. R. B. 1957-19, 42.

the Ninth Circuit in *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, which held under similar circumstances that Article XIV created an exemption. This opinion, which was followed by the court below in this case, adopts the "economic burden" analysis.[15] For the reasons advanced above we believe that decision to be erroneous, and accept instead the reasoning of Judge Carter in the decision there reversed, *American Trust Co.* v. *Smyth*, D. C. N. D. Cal., 141 F. Supp. 414. See in accord with the view we are taking the Note, 71 Harv. L. Rev. 1163 (1958), though contra are Note, 9 Stan. L. Rev. 610 (1957), and Note, 33 N. Y. U. L. Rev. 233 (1958).

Reversed and remanded for the entry of judgment for the defendant.

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[15] In *American Trust Co.* v. *Smyth*, 9 Cir., 247 F. 2d 149, the Ninth Circuit also laid some stress on the fact that this Convention, unlike many United States Conventions with other countries, did not have a "savings clause." This clause allows the United States to impose a tax on all of its residents or citizens or domestic corporations "as though this convention had not come into effect." E.g., Art. XIX(1) of the Convention with Norway, 62 Stat. (Part 2) 1764. Although the United Kingdom treaty does not have a clause precisely to this effect, the same limiting function is played by the definition of "resident of the United Kingdom" in Article II(1)(g), 60 Stat. (Part 2) 1378, which excludes citizens of the United States, United States corporations, and persons resident in the United States for the purpose of United States tax. Since only residents of the United Kingdom are granted any exemption from United States tax under the treaty, compare Articles III, VI, VII, VIII, IX, XI, XII, and XIV, this provision acts as a savings clause. Thus we ascribe no significance to the absence of such a clause from the United Kingdom Convention.

UNITED STATES COURT OF APPEALS

For the Second Circuit

At a Stated Term of the United States Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the fourteenth day of February one thousand nine hundred and sixty-two.

Present—Hon. Charles E. Clark,
Hon. Henry J. Friendly,
Hon. Irving R. Kaufman,
Circuit Judges.

Andre Maximov, as Trustee for the benefit of H. Robin Fedden u/a Dated 10/24/47,
Plaintiff-Appellee,

vs.

United States of America,
Defendant-Appellant.

Appeal from the United States District Court for the Southern District of New York.

This cause came on to be heard on the transcript of record from the United States District Court for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the judgment of said District Court be and it hereby is reversed and that the action be and it hereby is remanded for the entry of judgment for the defendant-appellant in accordance with the opinion of this court.

A. Daniel Fusaro,
Clerk.

A true copy,
A. Daniel Fusaro,
Clerk.

(Seal)

THE INCOME TAX CONVENTION BETWEEN THE UNITED STATES AND THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND (60 STAT. (PART 2) 1377)

By the President of the United States of America

A PROCLAMATION

Whereas a convention between the United States of America and the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed by their respective Plenipotentiaries at Washington on April 16, 1945;

And Whereas a supplementary protocol modifying in certain respects the said convention was signed by the respective Plenipotentiaries of the United States of America and the United Kingdom of Great Britain and Northern Ireland at Washington on June 6, 1946;

And Whereas the originals of the said convention and the said supplementary protocol are word for word as follows:

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland,

Desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income,

Have appointed for that purpose as their Plenipotentiaries:

The Government of the United States of America:

Mr. Edward R. Stettinius, Jr., Secretary of State, and

The Government of the United Kingdom of Great Britain and Northern Ireland:

The Right Honorable the Earl of Halifax, K.G., Ambassador Extraordinary and Plenipotentiary in Washington,

Who, having exhibited their respective full powers, found in good and due form, have agreed as follows:

ARTICLE I

(1) The taxes which are the subject of the present Convention are:

(a) In the United States of America:

The Federal income taxes, including surtaxes and excess profits taxes (hereinafter referred to as United States tax).

(b) In the United Kingdom of Great Britain and Northern Ireland:

The income tax (including surtax), the excess profits tax and the national defense contribution (hereinafter referred to as United Kingdom tax).

(2) The present Convention shall also apply to any other taxes of a substantially similar character imposed by either Contracting Party subsequently to the date of signature of the present Convention. * * *

ARTICLE II

(1) In the present Convention, unless the context otherwise requires:

* * * * *

(g) The term "resident of the United Kingdom" means any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for the purposes of United Kingdom tax and not resident in the United States for the purposes of United States tax. A

corporation is to be regarded as resident in the United Kingdom if its business is managed and controlled in the United Kingdom.

(h) The term "resident of the United States" means any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax, and any United States corporation and any partnership created or organized in or under the laws of the United States, being a corporation or partnership which is not resident in the United Kingdom for the purposes of United Kingdom tax.

(i) The term "United Kingdom enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United Kingdom.

(j) The term "United States enterprise" means an industrial or commercial enterprise or undertaking carried on by a resident of the United States.

(k) The terms "enterprise of one of the Contracting Parties" and "enterprise of the other Contracting Party" mean a United States enterprise or a United Kingdom enterprise, as the context requires.

(l) The term "permanent establishment" when used with respect to an enterprise of one of the Contracting Parties means a branch, management, factory or other fixed place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of such enterprise or has a stock of merchandise from which he regularly fills orders on its behalf. An enterprise of one of the Contracting Parties shall not be deemed to have a permanent establishment in the territory of the

other Contracting Party merely because it carries on business dealings in the territory of such other Contracting Party through a *bona fide* commission agent, broker or custodian acting in the ordinary course of his business as such. The fact that an enterprise of one of the Contracting Parties maintains in the territory of the other Contracting Party a fixed place of business exclusively for the purchase of goods or merchandise shall not of itself constitute such fixed place of business a permanent establishment of such enterprise. The fact that a corporation of one Contracting Party has a subsidiary corporation which is a corporation of the other Contracting Party or which is engaged in trade or business in the territory of such other Contracting Party (whether through a permanent establishment or otherwise) shall not of itself constitute that subsidiary corporation a permanent establishment of its parent corporation.

(2) For the purposes of Articles VI, VII, VIII, IX and XIV a resident of the United Kingdom shall not be deemed to be engaged in trade or business in the United States in any taxable year unless such resident has a permanent establishment situated therein in such taxable year. The same principle shall be applied, *mutatis mutandis*, by the United Kingdom in the case of a resident of the United States.

(3) In the application of the provisions of the present Convention by one of the Contracting Parties any term not otherwise defined shall, unless the context otherwise requires, have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the present Convention.

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ARTICLE VI

(1) The rate of United States tax on dividends derived from a United States coproration by a resident of the United Kingdom who is subject to United Kingdom tax on such dividends and not engaged in trade or business in the United States shall not exceed 15 per cent: * * *

(2) Dividends derived from sources within the United Kingdom by an individual who is (a) a resident of the United States, (b) subject to United States tax with respect to such dividends, and (c) not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom surtax.

* * * * *

ARTICLE VII

(1) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United States by a resident of the United Kingdom who is subject to United Kingdom tax on such interest and not engaged in trade or business in the United States, shall be exempt from United States tax; * * *

(2) Interest (on bonds, securities, notes, debentures, or on any other form of indebtedness) derived from sources within the United Kingdom by a resident of the United States who is subject to United States tax on such interest and not engaged in trade or business in the United Kingdom, shall be exempt from United Kingdom tax; * * *

* * * * *

ARTICLE XIII

(1) Subject to section 131 of the United States Internal Revenue Code * * *, United Kingdom tax shall be allowed as a credit against United States tax. * * *

(2) Subject to such provisions (which shall not affect the general principle hereof) as may be enacted in the United Kingdom, United States tax payable in respect of income from sources within the United States shall be allowed as a credit against any United Kingdom tax payable in respect of that income.

* * * * *

ARTICLE XIV

A resident of the United Kingdom not engaged in trade or business in the United States shall be exempt from United States tax on gains from the sale or exchange of capital assets.

ARTICLE XXIII

(1) The present Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) Upon exchange of ratifications, the present Convention shall have effect

(a) as respects United States tax, for the taxable years beginning on or after the first day of January 1945;

* * * * *

ARTICLE XXIV

(1) The present Convention shall continue in effect indefinitely but either of the Contracting Parties may, on or before the 30th day of June in any year after the year 1946, give to the other Contracting Party, through diplomatic channels, notice of termination * * *.

IN WITNESS WHEREOF the above-mentioned Plenipotentiaries have signed the present Convention and have affixed thereto their seals.

* * * * *

Now, Therefore, be it known that I, Harry S. Truman, President of the United States of America, do hereby proclaim and make public the said convention * * * to the end that the same and every article and clause thereof may be observed and fulfilled with good faith by the United States of America, and by the citizens of the United States of America; and all other persons subject to the jurisdiction thereof, the said convention * * * being deemed to have effect as provided in Article XXIII of the said convention, as aforesaid.

Done at the city of Washington this thirtieth day of July in the year of our Lord one thousand nine hundred forty-six and of the Independence of the United States of America the one hundred seventy-first.

Harry S. Truman

By the President:

Dean Acheson
Acting Secretary of State

OTHER MATERIAL PARTS OF OUR INTERNAL REVENUE CODE OF 1954

SEC. 641. IMPOSITION OF TAX.

(a) *Application of tax.*—The taxes imposed by this chapter on individuals shall apply to the taxable income of estates or of any kind of property held in trust, including—

(1) income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) *Computation and Payment.*—The taxable income of an estate or trust shall be computed in the same manner as in the case of an individual, except as otherwise provided in this part. The tax shall be computed on such taxable income and shall be paid by the fiduciary.

(26 U.S.C. 1958 ed., Sec. 641)

SEC. 643. DEFINITIONS APPLICABLE TO SUBPARTS A, B, C, AND D.

(a) *Distributable Net Income.*—For purposes of this part, the term "distributable net income" means, with

respect to any taxable year, the taxable income of the estate or trust computed with the following modifications—

* * * *

(3) *Capital Gains and Losses.*—Gains from the sale or exchange of capital assets shall be excluded to the extent that such gains are allocated to corpus and are not (A) paid, credited, or required to be distributed to any beneficiary during the taxable year * * *.

* * * *

(26 U.S.C. 1958 ed., Sec. 643)

SEC. 651. DEDUCTION FOR TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Deduction.*—In the case of any trust the terms of which—

(1) provide that all of its income is required to be distributed currently, and

(2) do not provide that any amounts are to be paid, permanently set aside, or used for the purposes specified in section 642 (c) (relating to deduction for charitable, etc., purposes),

there shall be allowed as a deduction in computing the taxable income of the trust the amount of the income for the taxable year which is required to be distributed currently. This section shall not apply in any taxable year in which the trust distributes amounts other than amounts of income described in paragraph (1).

* * * *

(26 U.S.C. 1958 ed., Sec. 651)

SEC. 652. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF TRUSTS DISTRIBUTING CURRENT INCOME ONLY.

(a) *Inclusion.*—Subject to subsection (b) the amount of income for the taxable year required to be distributed currently by a trust described in section 651 shall be included in the gross income of the beneficiaries to whom the income is required to be distributed, whether distributed or not. * * *

* * * *

(26 U.S.C. 1958 ed., Sec. 652)

SEC. 661. DEDUCTION FOR ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) *Deduction.*—In any taxable year there shall be allowed as a deduction in computing the taxable income of an estate or trust (other than a trust to which subpart B applies), the sum of—

(1) any amount of income for such taxable year required to be distributed currently (including any amount required to be distributed which may be paid out of income or corpus to the extent such amount is paid out of income for such taxable year); and

(2) any other amounts properly paid or credited or required to be distributed for such taxable year;

but such deduction shall not exceed the distributable net income of the estate or trust.

* * * *

(26 U.S.C. 1958 ed., Sec. 661)

SEC. 662. INCLUSION OF AMOUNTS IN GROSS INCOME OF BENEFICIARIES OF ESTATES AND TRUSTS ACCUMULATING INCOME OR DISTRIBUTING CORPUS.

(a) *Inclusion.*—Subject to subsection (b), there shall be included in the gross income of a beneficiary to whom an amount specified in section 661 (a) is paid, credited or required to be distributed (by an estate or trust described in section 661), the sum of the following amounts:

(1) *Amounts Required to be Distributed Currently.*—The amount of income for the taxable year required to be distributed currently to such beneficiary, whether distributed or not. * * *

(2) *Other Amounts Distributed.*—All other amounts properly paid, credited, or required to be distributed to such beneficiary for the taxable year. * * *

* * * *

(26 U.S.C. 1958 ed., Sec. 662)

CORRESPONDING PARTS OF SECTIONS 161 AND 162 OF OUR INTERNAL REVENUE CODE OF 1939

Section 161. Imposition of Tax.

(a) Application of tax.—The taxes imposed by this chapter upon individuals shall apply to the income of estates or of any kind of property in trust, including—

(1) Income accumulated in trust for the benefit of unborn or unascertained persons or persons with contingent interests, and income accumulated or held for future distribution under the terms of the will or trust;

(2) Income which is to be distributed currently by the fiduciary to the beneficiaries, and income collected by a guardian of an infant which is to be held or distributed as the court may direct;

(3) Income received by estates of deceased persons during the period of administration or settlement of the estate; and

(4) Income which, in the discretion of the fiduciary, may be either distributed to the beneficiaries or accumulated.

(b) Computation and payment.—The tax shall be computed upon the net income of the estate or trust, and shall be paid by the fiduciary, except as provided in section 166 (relating to revocable trusts) and section 167 (relating to income for benefit of the grantor).

* * * *

Section 162. Net income.

The net income of the estate or trust shall be computed in the same manner and on the same basis as in the case of an individual, except that—

* * * *

(b) There shall be allowed as an additional deduction in computing the net income of the estate or trust the

amount of the income of the estate or trust for its taxable year which is to be distributed currently by the fiduciary to the legatees, heirs, or beneficiaries, but the amount so allowed as a deduction shall be included in computing the net income of the legatees, heirs, or beneficiaries whether distributed to them or not. As used in this subsection, "income which is to be distributed currently" includes income for the taxable year of the estate or trust which, within the taxable year, becomes payable to the legatee, heir, or beneficiary. Any amount allowed as a deduction under this paragraph shall not be allowed as a deduction under subsection (c) of this section in the same or any succeeding taxable year;

(c) In the case of income received by estates of deceased persons during the period of administration or settlement of the estate, and in the case of income which, in the discretion of the fiduciary, may be either distributed to the beneficiary or accumulated, there shall be allowed as an additional deduction in computing the net income of the estate or trust the amount of the income of the estate or trust for its taxable year, which is properly paid or credited during such year to any legatee, heir, or beneficiary, but the amount so allowed as a deduction shall be included in computing the net income of the legatee, heir, or beneficiary.

* * * *